

Message Text

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ACTION EB-07

INFO OCT-01 NEA-06 ISO-00 AEC-05 AID-05 CEA-01 CIAE-00

CIEP-01 COME-00 DODE-00 FEAE-00 FPC-01 H-01 INR-05

INT-05 L-02 NSAE-00 NSC-05 OMB-01 PM-03 RSC-01 SAM-01

OES-03 SP-02 SS-15 STR-01 TRSE-00 FRB-01 /073 W

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R 101100Z DEC 74

FM AMEMBASSY ALGIERS

TO SECSTATE WASHDC 1534

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E.O. 11652: N/A

TAGS: ECON, AG

SUBJ: ALGERIAN ECONOMIC DEVELOPMENT

REF: (A) ALGIERS A-051 (B) ALGIERS 2454

SUMMARY: ALGERIAN ECONOMIC DEVELOPMENT IS DEPENDENT ON THREE FACTORS--REVENUE FROM HYDROCARBONS, EDUCATION AND TRAINING OF WORKERS, AND SMOOTH AND IMPROVED OPERATION OF THE ECONOMY BY THE GOVERNMENT. THIS CABLE FOLLOWS REF A ON THE OVERALL SITUATION IN ALGERIA AND FOCUSES ON ALGERIAN HYDROCARBON REVENUES. SPECIFICALLY, THE OIL REVENUES FORESEEN BY THE FOUR-YEAR DEVELOPMENT PLAN ARE TOO OPTIMISTIC UNLESS SUBSTANTIAL NEW PRODUCTION IS FOUND, BUT STILL LARGE ENOUGH TO MEET ALGERIA'S PRIORITY NEEDS. TOWARD THE END OF THE PERIOD ADDITIONAL REVENUE FROM ALGERIAN LNG IS FORECAST, BUT THE TECHNICAL PROBLEMS IN OPERATING THESE HUGE FACILITIES AND RISING CAPITAL COSTS CAST SOME DOUBT ON ALGERIAN BASE LOAD LNG PROJECTS. WE SUGGEST A FINANCIAL AND TECHNICAL REEXAMINATION. END SUMMARY.

1. ALGERIA'S ECONOMIC DEVELOPMENT IS DEPENDENT ON HYDROCARBONS. IN 1973, ABOUT 21 PERCENT OF THE GROSS LIMITED OFFICIAL USE

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DOMESTIC PRODUCT WAS FROM THE HYDROCARBON SECTOR.

HOWEVER, THE JUMP IN THE PRICE OF OIL RAISES THE VALUE OF THE HYDROCARBON SECTOR TO ABOUT 50 PERCENT OF GDP AND INCREASES TOTAL GDP ABOUT 45 PERCENT. ALGERIA'S FOUR YEAR PLAN (1974-1977) REF A FORECASTS SOME 4.8 BILLION DOLLARS OF INVESTMENT IN THE HYDROCARBON SECTOR. THIS WILL RAISE THE VALUE OF HYDROCARBON PRODUCTION FROM 5.4 TO 7.5 BILLION DOLLARS WHICH MEANS HYDROCARBONS WILL STILL ACCOUNT FOR 45 PERCENT OF GDP BY THE END OF 1977. EVEN MORE STRIKING IN THE DEPENDENCE OF ALGERIA ON HYDROCARBONS FOR FOREIGN EXCHANGE. IN 1973 (1974 OIL PRICES) ALGERIA HYDROCARBON EXPORTS SHOULD HAVE EARNED 5.3 BILLION DOLLARS AND ARE FORECAST TO EARN IN 1977, 7.5 BILLION DOLLARS OR 93 PERCENT OF TOTAL ALGERIAN EXPORTS IN BOTH THOSE YEARS.

2. THE ACCURACY OF THESE FORECASTS DEPENDS ON THE PRICE OF OIL BEING DOLS. 14 A BARREL. AT THE PRESENT PRICE OF DOLS. 12.50, THERE IS ALREADY A SHORTFALL OF ABOUT 700 MILLION DOLLARS A YEAR AT PRESENT PRODUCTION RATES.

3. THE OTHER VARIABLE IN THESE FORECASTS IS THE QUANTITY OF OIL AND CONDENSATE EXPORTED. IN 1973, ALGERIA EXPORTED 45.2 MILLION TONS OF CRUDE AND CONDENSATE. IN 1977 ALGERIA PLANS TO EXPORT 58.8 MILLION TONS OF CRUDE OIL AND CONDENSATE. THIS IS AN INCREASE OF OVER 30 PERCENT. CONDENSATE PRODUCTION COMES FROM THE GAS AND IS DIRECTLY DEPENDENT ON THE VOLUME OF GAS PRODUCED, WHICH IN TURN DEPENDS ON THE EXPORT OF LNG WHICH IS DISCUSSED LATER.

4. ALGERIA WAS EXPLORED BY THE FRENCH AND THEY FOUND MOST OF THE PRESENT OIL FIELDS. THESE FIELDS HAVE HAD STABLE PRODUCTION LEVELS FOR THE LAST THREE YEARS. SOME WELLS ARE DECLINING IN PRODUCTION, BUT NEW DRILLING HAS HELD PRODUCTION AT THE SAME LEVEL. HASSI-MESSAOUD WHICH PRODUCES OVER HALF OF ALGERIAN CRUDE PRODUCED, ABOUT 27 MILLION TONS IN 1973, WILL BE DOWN TO LESS THAN 25 IN 1974, AND 22.5 IN 1975 BEFORE REINJECTION WILL RAISE THE FIELD PRESSURE AGAIN TO A LEVEL TO INCREASE PRODUCTION IN 1976. EVEN WITH REINJECTION, PEAK LIMITED OFFICIAL USE

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PRODUCTION WILL MAXIMIZE AT 32 MILLION TONS IN 1980. THIS DECLINE WILL BE ABOUT MATCHED BY THE NEW STAH FIELD COMING ON LINE IN JULY 1975 AND THE NEW FRENCH FIELD OF MEREKSIN.

5. HOWEVER, SONATRACH PREDICTED A PRODUCTION LEVEL OF ABOUT 60 MILLION TONS IN 1974, AND IN ITS FAMOUS MESSAGE OF SEPTEMBER 1973 HAD TO CUTBACK ON ITS

DELIVERIES TO BUYERS IN BOTH 1973 AND 1974 DUE TO PRODUCTION SHORTFALLS.

6. SONATRACH HAS HAD A MAJOR EXPLORATION AND DRILLING PROGRAM GOING FOR THE LAST FIVE YEARS, AND HAS INVESTED OVER 100 MILLION DOLLARS A YEAR, BUT THE RESULTS HAVE BEEN MEAGER TO DATE. ITS FUTURE EXPLORATION PROGRAM IS EVEN GREATER AND THE COMPANY HAS SIGNED A NUMBER OF JOINT EXPLORATION VENTURES WITH FOREIGN OIL COMPANIES WHICH SHOULD ADD ANOTHER 100 MILLION DOLLARS OF EXPLORATION A YEAR FOR THE NEXT FOUR TO FIVE YEARS. IN THE FIRST YEAR AN A HALF OF THESE JOINT VENTURES, HISPANOIL HAS FOUND AN OIL POCKET WHICH THEY ARE TESTING. CFP HAS FOUND OIL AT MERKESIN WHICH SEEMS TO BE EXPLOITABLE. SUN OIL HAS FOUND NOTHING COMMERCIAL SO FAR.

7. U.S. SEISMIC EXPERTS SAY THERE ARE MANY POTENTIAL FORMATIONS IN THE ALGERIAN DESERT. THE FACT THAT SUN AND AMOCO ARE DRILLING AND MOBIL AND SHAHEEN HAVE INITIALED TO DRILL SPEAKS WELL FOR ALGERIA'S PROSPECTS, BUT EXXON, GULF AND SHELL ARE ALL HOLDING BACK BECAUSE OF REAL DOUBTS THAT THERE ARE LARGE UNDISCOVERED OIL RESERVES. THEY ARE MORE CONFIDENT ABOUT FINDING NEW GAS RESERVES, BUT THEY WANT OIL.

8. IN SUM, OUR CONSERVATIVE ESTIMATE IS THAT ALGERIAN CRUDE EXPORTS WILL HOLD STEADY IN 1975-1977 AT ABOUT 45 MILLION TONS A YEAR. SMALL NEW FINDS AND IMPROVED FIELD RECOVERY WILL AUGMENT PRODUCTION BUT NO MORE THAN THE DECLINE IN WELL PRODUCTION. AFTER 1977, A MAJOR NEW FIND COULD CHANGE THIS FORECAST, BUT ALSO MAJOR NEW REFINERIES WILL BE USING OVER 20 MILLION TONS OF ALGERIA'S LIMITED OFFICIAL USE

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LIMITED CRUDE OIL SUPPLY AVAILABLE FOR EXPORT.

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INFO OCT-01 NEA-06 ISO-00 AEC-05 AID-05 CEA-01 CIAE-00

CIEP-01 COME-00 DODE-00 FEAE-00 FPC-01 H-01 INR-05

INT-05 L-02 NSAE-00 NSC-05 OMB-01 PM-03 RSC-01 SAM-01

OES-03 SP-02 SS-15 STR-01 TRSE-00 FRB-01 /073 W

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9. BY 1977 THIS PREDICTED SHORTFALL IN CRUDE OIL PRODUCTION TRANSLATES INTO A FOREIGN EXCHANGE LOSS OF ABOUT 1.3 BILLION DOLLARS.. THIS WILL MEAN SOME BELT TIGHTENING AND INCREASED BORROWING, BUT IS NOT ENOUGH TO JEOPARDIZE THE OVERALL DEVELOPMENT PLANS. FURTHER, THIS BEGINS TO HURT IN 1977 WHEN ALGERIAN GAS EXPORTS SHOULD BEGIN TO EARN SIZEABLE FOREIGN EXCHANGE SUMS.

10. ALGERIA'S RESERVES OF GAS AS DISTINCT FROM HER OIL RESERVES ARE AMONG THE LARGEST IN THE WORLD. PRESENT BEST ESTIMATES PLACE GAS RESERVES AT ABOUT THREE TRILLION CUBIC METERS. TO EXPLOIT THESE GAS RESERVES ALGERIA HAS COMMITTED ITSELF TO A HUGE GAS RELIQUIFICATION PROGRAM. ALGERIA HAS CONTRACTED TO SELL SOME 32.4 BILLION CUBIC METERS A YEAR AND HAS PENDING ADDITIONAL SALES OF SOME 38 BILLION CUBIC METERS.

11. TO LIQUIFY THIS GAS ALGERIA HAS BUILT OR IS BUILDING LIQUIFICATION PLANTS AT : (1) CAMEL - PRODUCTION TWO BILLION CUBIC METERS A YEAR BEGINNING IN 1964, (2) SKIKDA TRAINS 1 - 3, PRODUCTION 4 BILLION CUBIC METERS A YEAR BEGINNING IN 1972, (3) SKIKDA TRAIN 4, PRODUCTION TWO BILLION CUBIC METERS A YEAR IN 1974, (4) LIMITED OFFICIAL USE

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ARZEW TRAINS 1 - 6, PRODUCTION 10 BILLION CUBIC METERS A YEAR IN 1976, (5) SKIKDA TRAINS 5 AND 6, PRODUCTION 5 BILLION CUBIC METERS A YEAR IN 1977, (6) ARZEW 6 - 21, 25 BILLION CUBIC METERS A YEAR IN 1979.

12. THE SIZE AND CAPITAL INVESTMENT FROM THE FILED TO CONSUMER OF THESE PROJECTS IS STAGGERING AND INFLATION HAS HIT THEM HARD, FOR EXAMPLE, GAS FIELD

PREPARATION UNIT COSTS ABOUT 160 MILLION FOR A 20 BILLION CUBIC METER PLANT, PIPELINE AND PUMPING STATIONS ABOUT 150 MILLION, A 1 BILLION CUBIC METER LIQUIFICATION PLANT ABOUT 350 MILLION IN EARLY 1973, AND ESTIMATED AT NEAR 600 MILLION IN LATE 1974, A NEW PORT FOR 250 MILLION, AND EACH TANKER ABOUT 80 MILLION ORDERED IN EARLY 1973, 100 MILLION IN 1974 AND ABOUT 120 MILLION NOW. A ROUGH TOTAL CAPITAL INVESTMENT PER 1 BILLION CUBIC METERS OF GAS A YEAR DELIVERED TO THE UNITED STATES IS BETWEEN 1.8 AND 2 BILLION DOLLARS.

13. CAMEL AND BRUNEI PROVE THE LNG SYSTEMS CAN WORK, BUT THE HISTORY OF TROUBLES IN ALGERIA IN THE EARLY YEARS OF CAMEL AND SKIKDA ARE SUCH THAT ONE HAS TO ALLOW FOR SOME YEARS OF TROUBLES AFTER THE START-UP DATES CITED BEFORE. FURTHER THE ALGERIAN PROJECTS ARE SO LARGE THAT THEY WILL DEMAND HIGH CALIBRE MANAGEMENT ON THE PART OF THE ALGERIANS. UNFORTUNATELY, THIS IS A NEW AREA FOR THEM AND RAISES ANEW THE QUESTION OF WHETHER THE ALGERIANS CAN MANAGE THEIR COMPLEX ECONOMY.

14. TWO OTHER RELATED UNKNOWNNS FURTHER CLOUD THE ALGERIAN LNG PICTURE. ONE ALREADY ALLUDED TO IS INFLATION AND HIGH INTEREST RATES. THE COSTS OF THE EUROGAS I LNG PROJECT HAVE GOTTEN SO LARGE THAT CONCESSIONARY INTEREST RATES ARE NECESSARY. EVEN WITH THE PRESENT LOW ALGERIAN GAS PRICE, THE COSTS OF THE PROJECT MAKE THIS EXPENSIVE GAS. AT THE MOMENT EUROGAS I SALE IS COLLAPSING DUE TO THE INABILITY OF THE EUROPEAN PURCHASERS TO SUPPLY SO MUCH CAPITAL AT SUCH LOW INTEREST RATES. THE EUROPEANS ASKED FOR GAS PRICE GUARANTEES TO SUPPORT THE CONCESSIONARY LOANS, BUT THE ALGERIANS LIMITED OFFICIAL USE

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HAVE TURNED DOWN THIS PROPOSAL. THE ALGERIANS ARE SELLING GAS UNDER THE EARLY CONTRACTS AT PRICES FROM 30 - 45 CENTS A MILLION BTU. HOWEVER, OTHER COUNTRIES ARE SELLING GAS AT ABOUT DOLS. 1.00 A MILLION BTU AND THE EQUIVALENT BTU PRICE OF OIL IS ABOUT DOLS. 1.62 A MILLION BTU. THIS BRINGS ATTENTION TO THE OTHER UNKNOWN. THE ALGERIANS WOULD LIKE TO RAISE THEIR PRICE FOR GAS AND ARE TALKING TO THE OTHER LARGE GAS EXPORTING COUNTRIES -- IRAN AND LIBYA.

15. A FINAL TECHNICAL PROBLEM IS THE PRESENCE OF MERCURY IN THE HASSI-R'MEL GAS OF ALGERIA. THE MERCURY AT SKIKDA CLOSED DOWN TRAIN I FOR ONE YEAR DUE TO CORROSION. PRITCHARD, THE BUILDER OF TRAIN 4 AT SKIDA DOES NOT BELIEVE ITS PLANT SHOULD BE RUN

WITH MERCURY IN THE GAS. CHEMICO DOES NOT SEEM
NEARLY SO WORRIED.

16. THE CAPITAL SUMS INVOLVED ARE SO LARGE AND
THE CAPITAL COSTS AND REVENUE SO IMPORTANT TO THE
ALGERIAN FOREIGN EXCHANGE PICTURE THAT THE EMBASSY
BELIEVES A NEW TECHNICAL AND FINANCIAL STUDY
SHOULD BE MADE OF ALGERIAN LNG EXPORT PROJECTS.

17. FOR ALGERIA'S DEVELOPMENT PLAN UP THROUGH 1977,
GAS IS NOT TOO IMPORTANT AND THE PROJECTS ARE WELL
UNDERWAY. THE PLAN ONLY FORECASTS 14 BILLION CUBIC
METERS OF GAS EXPORTED IN 1977 OR ABOUT 500 MILLION
DOLLARS AT PRESENT PRICES. CONSERVATIVELY, CAMEL
AND SKIKDA 1 - 4 SHOULD BE OPERATING AND HAVE ALL
THE NECESSARY FACILITIES COMPLETED SO THAT 7 - 8 BILLION
CUBIC METERS OF LNG EXPORTS FROM ALGERIA CAN BE EXPECTED
IN 1977. THE REQUESTED REVIEW WOULD BE IN ORDER TO
PREPARE A CONCISE U.S.G. POSITION ON THE PENDING GAS
CONTRACTS BETWEEN U.S. COMPANIES AND ALGERIA. IT WOULD
ALSO CLARIFY THE LONGER TERM FOREIGN EXCHANGE POSITION
OF ALGERIA WHICH WITH THE SHORTFALLS CITED ABOVE AND
POSSIBLE LARGE BORROWINGS FOR HUGE PROJECTS MAKES THE
5 - 10 YEAR FORECAST MORE QUESTIONABLE. BARR

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: INDUSTRIAL DEVELOPMENT, FOREIGN INVESTMENT, FOREIGN TRADE
Control Number: n/a
Copy: SINGLE
Draft Date: 10 DEC 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: boyleja
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974ALGIER02737
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D740358-0101
From: ALGIERS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19741248/aaaabpec.tel
Line Count: 300
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EB
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: (A) ALGIERS A-051 (B) ALGIERS 2454
Review Action: RELEASED, APPROVED
Review Authority: boyleja
Review Comment: n/a
Review Content Flags:
Review Date: 14 AUG 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <14-Aug-2002 by elyme>; APPROVED <18 MAR 2003 by boyleja>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ALGERIAN ECONOMIC DEVELOPMENT
TAGS: ECON, AG
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005